

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;  
Nora Mead Brownell, and Suedeene G. Kelly.

SFPP, L.P.

Docket No. IS06-283-000

ORDER ACCEPTING AND SUSPENDING TARIFF, SUBJECT TO REFUND,  
AND ESTABLISHING HEARING PROCEDURES

(Issued May 31, 2006)

1. On May 1, 2006, SFPP, L.P. (SFPP) submitted FERC Tariff No. 122, a tariff filing with a cost-of-service justification, that proposes to increase rates for the transportation of petroleum products on its East Line system.<sup>1</sup> As detailed below, the Commission accepts and suspends the tariff to become effective June 1, 2006, as proposed, subject to refund, and sets this matter for hearing.

**I. SFPP's Filing**

2. FERC Tariff No. 122, which cancels FERC Tariff No. 119, increases the transportation rates for movements between the El Paso and Diamond Junction origins to the destinations of Lordsburg, New Mexico, and Tucson and Phoenix, Arizona, by 69.1 percent, 77.4 percent and 55.3 percent, respectively. SFPP states the rate increases reflect costs of approximately \$202 million incurred to expand the East Line system's capacity from approximately 90,000 barrels per day (bpd) to approximately 147,000 bpd from El Paso to Tucson, and from 55,000 bpd to 99,000 bpd from Tucson to Phoenix. According to SFPP, this expansion project includes the installation of larger diameter pipes and looping of its mainline, and the construction of a breakout facility to allow shippers to maintain their existing incoming pumping rates and still benefit from the increased mainline tariff rates.

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<sup>1</sup> From El Paso and Diamond Junction (El Paso County), Texas, to Lordsburg (Hidalgo County), New Mexico, and Tucson (Pima County) and Phoenix (Maricopa County), Arizona.

3. Pertinent to the instant filing, SFPP states that in a January 30, 2003 Declaratory Order,<sup>2</sup> the Commission granted SFPP's petition and confirmed certain matters regarding the Commission's handling of a future tariff filing adjusting the East Line rates following its expansion project, including the finding that: (1) such a capital expansion forms an appropriate basis for seeking a substantial divergence filing under section 342.4(a) of the Commission's oil pipeline regulations in order to recover its capital investment through cost-based rates; (2) SFPP's expected showing, post-expansion, of a 20 percent divergence between costs and revenues under its indexed rates would satisfy the substantial divergence standard; and (3) SFPP would be entitled to a short suspension of its later tariff filing, subject to the *Buckeye* standard.<sup>3</sup>

4. Therefore, SFPP states it is filing the instant tariff in accordance with section 342.4(a) of the Commission's regulations, which requires that SFPP demonstrate a substantial divergence between its actual costs and its ceiling rates such that the ceiling rates would preclude SFPP from being able to charge just and reasonable rates. SFPP continues that, in accordance with 18 C.F.R. Part 346 of the Commission's regulations, it submitted cost, revenue, and throughput data supporting the revised rates reflected in the instant tariff and its proposed ceiling rates. SFPP claims that its supporting schedules show a substantial divergence between the actual costs experienced by the carrier from the construction and the rates resulting from application of the oil pipeline annual cost increase index.

5. SFPP states it used calendar year 2005 as the base period, and January 1, 2006 through September 30, 2006 for the test period. SFPP calculates a cost of service of \$56,719,000 for the test period.<sup>4</sup> According to SFPP, test period revenue under the current ceiling rates projects to approximately \$31,591,000, resulting in an under-recovery of approximately \$25,128,000 per year or 45 percent. Under the proposed rates, SFPP states its test period revenue is projected to be approximately \$56,767,000.

6. SFPP states its income tax allowance is calculated in accordance with the Commission's *Order on Initial Decision and on Certain Remanded Issues*, issued December 16, 2005 in the Docket No. OR92-8, *et al.*, proceeding.<sup>5</sup>

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<sup>2</sup> *SFPP, L.P.*, 102 FERC ¶ 61,089 (2003) (Declaratory Order), *Order on Reh'g*, 104 FERC ¶ 61,163 (2003).

<sup>3</sup> Declaratory Order at P 30.

<sup>4</sup> On May 2, 2006, SFPP submitted an errata page to correct this value.

<sup>5</sup> *SFPP, L.P., et al.*, 113 FERC ¶ 61,277 (2005) (December 2005 Order).

7. SFPP makes test period adjustments to its operating expenses to reflect incremental expansion costs including an adjustment (of approximately 1.79 cents per barrel applied uniformly to all the proposed East Line rates for a period of five years) to reflect a normalized estimate of the average annual cost of litigation for the instant filing.
8. Finally, SFPP states the instant filing is complete under the Commission's applicable regulations and requests that, consistent with the Declaratory Order and the Commission's Buckeye standard, FERC Tariff No. 122 be afforded a shortened suspension and made effective June 1, 2006.

## **II. Interventions, Protests, and Responses**

9. On May 16, 2006, timely motions to intervene and protest were filed jointly by BP West Coast Products LLC and ExxonMobil Oil Corporation (BP and ExxonMobil), ConocoPhillips Company (ConocoPhillips), Navajo Refining Company, L.P. (Navajo), jointly by Valero Marketing and Supply Company and Chevron Products Company (Valero and Chevron), and Western Refining Company, L.P (Western). SFPP filed an answer to the protests on May 22, 2006.
10. The protesting parties oppose the proposed rate increase and request the Commission suspend the filing's proposed rates, subject to refund, and set the instant docket for hearing. Further, BP and ExxonMobil, Navajo and Western request suspension for the maximum statutory seven-month period while ConocoPhillips requests the Commission deny the rate increase and reject the filing.
11. SFPP replies that it has fully complied with the Commission's regulations and that the various protests are without merit. It therefore concludes that the Commission should accept the filing without suspension or further investigation. It further asserts that it intends to place the expanded and improved East Line facilities in service on June 1, 2006, and it should be allowed to begin recovery of its expenses immediately. Thus, if the Commission should decide to begin an investigation, any suspension should not exceed the minimum suspension period.

## **III. Positions on Protested Issues**

12. All protesting parties object to SFPP's use of a full corporate income tax allowance in support of its cost of service calculation. SFPP answered that it has complied with the standards contained in the Commission's Policy Statement on Income Tax Allowances and the guidelines contained in the December 2005 Order.

13. ConocoPhillips, as well as Valero and Chevron, claim that SFPP's capital structure calculations for years prior to 2005 are not adjusted to remove purchase accounting adjustment (PAA) write-ups of equity as required by the Commission's prior orders.<sup>6</sup> SFPP responds that the Commission's prior orders only required the PAA to be removed for the test years 1998 and 1999.

14. BP and others state that SFPP proposes a real equity rate of return of 9.2 percent, and question the use of KMEP, a master limited partnership (MLP), to support this return given the Commission's prior decision in *HIOS*.<sup>7</sup> Western asserts that on rehearing of *HIOS*,<sup>8</sup> the Commission held that it would not use MLP distributions to determine a pipeline's allowed return on equity unless it is shown that the distributions consisted entirely of return on equity. SFPP replies that the Commission has previously determined that there is no other practical alternative to the inclusion of MLPs in the proxy group when addressing the cost of equity for oil pipelines. It notes that the proxy group used here is consistent with the one adopted in earlier proceedings involving its rates.

15. ConocoPhillips, Valero and Chevron, and Western claim that SFPP omits \$716 million of long-term debt from its weighted cost of debt, despite the fact that SFPP treats the \$716 million as long-term in calculating its capital structure. SFPP replies that while its short term commercial paper is carried as long term debt on KMEP's books, the interest rate is unstable and unrepresentative until replaced by longer term instruments. SFPP further asserts that certain of KMEP's debt is in the nature of local government development bonds that could not be used to support SFPP's operations and as such were properly excluded from its debt calculations.

16. BP and ExxonMobil state that SFPP uses actual volumes in 2005, the first year the expansion facilities were placed in service, adjusted for known and measurable changes, to determine its proposed rates. They state that these volumes represent only a portion of the expanded capacity of the pipeline and therefore SFPP's throughput may be understated. SFPP replies that its projections are reasonable and it is unlikely that its expanded system will operate at full capacity 100 percent of the time. Moreover, if it were to do so, its operating expenses would be higher.

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<sup>6</sup> *SFPP, L.P.*, 113 FERC ¶ 61,277 at PP. 64-72 (2005).

<sup>7</sup> *High Island Offshore System, L.L.C.*, 110 FERC ¶ 61,043 (2005).

<sup>8</sup> 112 FERC ¶ 61,050 (2005).

17. ConocoPhillips and Valero and Chevron state the instant filing does not provide work papers on how the base period or test period allocations of KMEP overhead were performed. Navajo questions SFPP's overhead allocations, the reasonableness of the PHMSA consent agreement, and the recovery of East Line litigation expenses. Western adds that it is unclear how such a dramatic increase in operating costs based on an expansion can be supported and that SFPP combines the gross plant and labor cost ratios in violation of established Commission policy and the KN Method.<sup>9</sup> Finally, Western asserts that since the instant rates are filed as new rates, SFPP should not be permitted to index those rates under the Commission's annual indexing procedure in future years.

18. SFPP replies that its operating expenses are based on the Commission's oil pipeline cost-of-service rate making methodology and that it has complied with the KN Method. It further asserts that its projected litigation expense is based on its practical experience of more than a decade of litigation involving its rates, and in any event it will refund any portion of the litigation costs not actually incurred. SFPP further asserts that protestants ignore the provisions the Commission's indexing regulations, which explicitly permit an adjustment to the rates at issue here pursuant to section 342.3(d) of the Commission's regulations.<sup>10</sup> SFPP contends that since its proposed filing is part of the current index year encompassing July 1 to June 30,<sup>11</sup> it could apply the indexing adjustment for the next index year (July 1, 2006 to June 30, 2007) to this new ceiling rate.

19. ConocoPhillips claims SFPP does not provide rationale for its treatment of all investment in carrier property as mileage-based cost. Western also questions several of SFPP's East Line rate base items, including SFPP's claimed cost for "Engineering, Management, ROW and Permitting," when the expansion was presumably built on right-of-way already held by SFPP. Western states it is unclear if SFPP has included in its rate base any costs related to later phases of its expansion which have not been completed, and if so, such costs should be removed. SFPP replies that each of these expenses is justified by its regulatory cost accounts, and that the Commission should accept them.

#### **IV. Discussion**

20. The Commission finds that SFPP has made an adequate initial showing that its filing meets the requirements of a cost-of-service filing, under 18 C.F.R. § 346.1 of the

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<sup>9</sup> December 2005 Order at P 89.

<sup>10</sup> 18 C.F.R. § 342.3(d)(5) (2005).

<sup>11</sup> 18 C.F.R. § 342.3(c).

Commission's regulations based on the cost figures provided in its filing. The filing, however, presents numerous cost-of-service and other rate case issues that cannot be resolved on the current record. Accordingly, the Commission will accept and suspend the filing, subject to refund, and set it for hearing.

21. Protesters have requested suspension of the filing for a maximum seven-months. The Commission, however, in the January 30, 2003, Declaratory Order confirmed that SFPP would be entitled to a short suspension of this filing, subject to the *Buckeye* standard.<sup>12</sup> *Buckeye* established a general rule prescribing a minimum duration for oil pipeline rate suspensions except when it has been shown that a proposed rate increase may have significant anticompetitive effects or impose undue hardship on a shipper or group of shippers. No such showing has been made here. The Commission, therefore, will accept SFPP's filing to be effective June 1, 2006, as proposed. Finally, the propriety of an index filing by SFPP can be addressed at such time as SFPP actually makes such a filing for the period beginning July 1, 2006.

22. The issues of this case pertain to the data and methods that SFPP uses to determine its proposed rates. The resolution of these factual disputes will have a rate impact on the protestants and on other shippers using SFPP's East Line, but the impact of the filing is limited to those rates. To the extent there are common issues involved in other proceedings, they will be decided on the merits in each such proceeding. With regard to the instant proceeding, there is insufficient data at this time to resolve these disputes. Therefore the Commission will establish hearing procedures to examine all the issues raised by the filing.

## **V. Suspension**

23. Based upon a review of the filing, the Commission finds that SFPP's FERC Tariff No. 122 has not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory, or otherwise unlawful. Accordingly, the Commission will accept the tariff for filing and suspend it, to be effective June 1, 2006, subject to refund.

### **The Commission orders:**

(A) SFPP's FERC Tariff No. 122 is accepted for filing and suspended, to become effective June 1, 2006, subject to refund and subject to further order of the Commission.

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<sup>12</sup> See *Buckeye Pipe Line Company*, 13 FERC ¶ 61,267 (1980).

(B) Pursuant to the authority of the Interstate Commerce Act, particularly sections 15(1) and 15(7) thereof, and the Commission's regulations, a hearing is established to address the issues raised by SFPP's filing.

(C) A Presiding Administrative Law Judge (ALJ), to be designated by the Chief Administrative Law Judge, for the purpose pursuant to 18 C.F.R. § 375.302 (2005), shall convene a prehearing conference in this proceeding to be held within 20 days of the issuance this order in a hearing or conference room of the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426. The prehearing conference shall be held to clarify the positions of the participants, and for the ALJ to establish any procedural dates for the hearing. The ALJ is authorized to conduct further proceedings pursuant to this order and the Commission's Rules of Practice and Procedure.

By the Commission.

( S E A L )

Magalie R. Salas,  
Secretary.